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No. 04-1127

Supreme Court, U.S.
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In The Supreme Court of the United States

PREMIERE TECHNOLOGIES, INC., N /A PREMIERE GLOBAL SERVICES, INC., BOLAND T. JONES, PATRICK G. JONES, GEORGE W. BAKER, SR., and RAYMOND H. PIRTLE,

Petitioners,

v.

APA EXCELSIOR III, L.P., APA EXCELSIOR III OFFSHORE L.P., APA/FOSTIN PENNSYLVANIA VENTURE CAPITAL FUND, CIN VENTURE NOMINEES LIMITED, STUART A. EPSTEIN, and DAVID EPSTEIN,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

REPLY TO BRIEF IN OPPOSITION

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CORPORATE DISCLOSURE STATEMENT

Premiere Technologies, Inc., n/k/a Premiere Global Services, Inc., is a corporation organized under the laws of the State of Georgia. It does not have a parent corporation, and no publicly-held company owns 10 percent or more of the stock of the corporation.

TABLE OF CONTENTS

Page

CORPORATE DISCLOSURE STATEMENT i

TABLE OF AUTHORITIES iii

PETITIONERS' REPLY TO RESPONDENTS' REASONS FOR DENYING THE WRIT 1

I. Plaintiffs Do Not Dispute That There Exists a Conflict Among the Lower Courts as to the Applicability of *Gustafson* to Section 11 Claims 2

II. Plaintiffs' Arguments Would Incentivize Corporate Insiders to Breach Their Fiduciary Duties to Shareholders 6

CONCLUSION 8

TABLE OF AUTHORITIES

Page

CASES

Am. Constr. Co. v. Jacksonville, T. & K.W. Ry. Co., 148 U.S. 372 (1893) 6

Beam v. Stewart, 845 A.2d 1040 (Del. 2004) 8

Brosious v. Children's Place Retail Stores, 189 F.R.D. 138 (D.N.J. 1999) 2

Bhd. of Locomotive Firemen & Enginemen v. Bangor & Aroostook R.R. Co., 389 U.S. 327 (1967) 6

DeMaria v. Andersen, 318 F.3d 170 (2d Cir. 2003) 3

Gannon v. Cont'l Ins. Co., 920 F. Supp. 566 (D.N.J. 1996) 2

Gustafson v. Alloyd Co., 513 U.S. 561 (1995) ..... *passim*

Hamilton-Brown Shoe Co. v. Wolf Bros. & Co., 240 U.S. 251 (1916) 6

Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076 (9th Cir. 1999) 3

In re Enron Corp. Sec., Deriv. & ERISA Litig., 258 F. Supp. 2d 576 (S.D. Tex. 2003) 8

In re Oracle Corp. Deriv. Litig., 824 A.2d 917 (Del. Ch. 2003) 8

In re Walt Disney Co. Deriv. Litig., 825 A.2d 275 (Del. Ch. 2003) 8

Joseph v. Wiles, 223 F.3d 1155 (10th Cir. 2000) 3

McKowan Lowe & Co. v. Jasmine Ltd., 127 F. Supp. 2d 516 (D.N.J. 2000) 2

Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003) 7

TABLE OF AUTHORITIES

Page

Rosenzweig v. Azurix Corp., 332 F.3d 854 (5th Cir. 2003) 3

Sturm v. Marriott Marquis Corp., 26 F. Supp. 2d 1358 (N.D. Ga. 1998) 2

Warden v. Crown Am. Realty Trust, No. Civ.A. 96-25J, 1998 WL 725946 (W.D. Pa. Oct. 15, 1998) 2

STATUTES

15 U.S.C. §§ 77a-77z-3 1

15 U.S.C. § 77k ..... *passim*

15 U.S.C. § 77l(a)(2) 2

15 U.S.C. § 78j(b) 7

28 U.S.C. § 994 7

Sarbanes-Oxley Act of 2002 § 805 (2002) 7

Sarbanes-Oxley Act of 2002 § 1104 (2002) 7

OTHER

77 Cong. Rec. 2910 (May 5, 1933), *reprinted in* 1 Fed. Sec. Laws 168 (1983) 4

H.R. Rep. No. 73-85 (May 5, 1933) 4

SEC Chairman William H. Donaldson, Remarks Before the Directors Education Institute (Mar. 16, 2005) (*available at* http://www.sec.gov/news/speech/spch031605whd.htm) 8

PETITIONERS' REPLY TO RESPONDENTS' REASONS FOR DENYING THE WRIT

This Court explained in *Gustafson v. Alloyd Co.*, 513 U.S. 561 (1995), that the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77a to 77z-3, is intended to protect open-market investors who must make investment decisions based on limited public information. *See Gustafson*, 513 U.S. at 572. Here, Respondents/Plaintiffs are corporate directors and insiders who (1) had access to confidential, non-public information, and (2) as "gatekeepers" owed a fiduciary duty to the open-market shareholders to exercise reasonable due diligence with respect to the information that was available to them. *See* Pet. at 2-5. Pursuant to *Gustafson*, Plaintiffs are not investors who fall under the protective umbrella of the Securities Act and, accordingly, should not be permitted standing to assert a claim under Section 11, 15 U.S.C. § 77k. This case, thus, presents an opportunity for the Court to clarify the scope of the Securities Act and underscores the importance to the integrity of the markets in having gatekeepers fulfill their fiduciary duty.

Lower courts have applied *Gustafson* inconsistently to Section 11 claims. Some of the lower courts' holdings have extended the reach of a Section 11 claim far beyond its intended limits by permitting broad Section 11 standing, which has ultimately incorporated even those investors, like Plaintiffs here, who are corporate directors and insiders who made their investment decision prior to the effective date of a registration statement pursuant to a privately-negotiated transaction that provided them due diligence rights and access to confidential, inside information. As demonstrated in both Petitioners'/Defendants'

opening papers and below, these opinions do not square with this Court's holding in *Gustafson*.

I. Plaintiffs Do Not Dispute That There Exists a Conflict Among the Lower Courts as to the Applicability of *Gustafson* to Section 11 Claims.

In *Gustafson*, the Supreme Court held that Section 12(a)(2) of the Securities Act, 15 U.S.C. § 77l(a)(2), applies only to securities sold in the public markets based on limited publicly-available information. *Gustafson*, 513 U.S. at 580. Recognizing the lower standard of proof required under the Securities Act, *Gustafson* established unequivocally that the Securities Act creates duties "in connection with public offerings" and that it is a limited statute that does not impact transactions that are "beyond the need of public protection. . . ." *Gustafson*, 513 U.S. at 571-72. Accordingly, under *Gustafson*, Section 11 should also be narrowly construed, and standing to bring a claim thereunder should be limited to purchasers who require public protection and who acquired, in the public market, shares that were issued pursuant to a registration statement. Some lower courts have recognized this authority and have ruled in line with it. *See, e.g.*, *McKowan Lowe & Co. v. Jasmine Ltd.*, 127 F. Supp. 2d 516, 543 (D.N.J. 2000), *vacated on other grounds by*, 295 F.3d 380 (3d Cir. 2002); *Brosious v. Children's Place Retail Stores*, 189 F.R.D. 138, 144 (D.N.J. 1999); *Sturm v. Marriott Marquis Corp.*, 26 F. Supp. 2d 1358, 1370 (N.D. Ga. 1998); *Warden v. Crown Am. Realty Trust*, No. Civ.A. 96-25J, 1998 WL 725946, at *2 (W.D. Pa. Oct. 15, 1998); *Gannon v. Cont'l Ins. Co.*, 920 F. Supp. 566, 575 (D.N.J. 1996).

In contravention to *Gustafson*'s guidance as to the scope of the Securities Act, other lower courts have

deemed *Gustafson* inapplicable to Section 11 and have issued opinions that attempt to expand the scope of the Securities Act. These courts have specifically noted that a broader reading of Section 11 is "truer to the legislative spirit behind the Securities Act in providing the broadest possible protection to purchasers. . . ." *Joseph v. Wiles*, 223 F.3d 1155, 1161 (10th Cir. 2000). Disregarding the parallel principles underlying Section 11, Section 12, and the Securities Act as a whole, courts so inclined have ruled that "there is nothing in the reasoning or underlying logic of *Gustafson* that indicates that we should read into Section 11 [the narrow requirements] of Section 12." *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1081 (9th Cir. 1999); *see also DeMaria v. Andersen*, 318 F.3d 170, 178 (2d Cir. 2003); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 873 (5th Cir. 2003). Such an expansive reading of the Securities Act as applied to Section 11, however, is in conflict with this Court's mandate in *Gustafson* and makes the lower court split on the issue prime for review on a writ of certiorari.

Plaintiffs' Brief in Opposition overlooks the current confounded state of the law as to *Gustafson* and its applicability to Section 11. Plaintiffs argue, in conclusory fashion, that, even if *Gustafson* applied to their Section 11 claim, "resolution of the question [the Petition] attempts to present is irrelevant to the case at bar [because Plaintiffs'] position consistently has been that *Gustafson* confirms their standing in this case because they received stock pursuant to a registration statement and prospectus filed with the SEC to effectuate a public offering." Br. in Opp'n at 6. Plaintiffs' argument misses the point.

In this case, the plaintiffs asserting standing are directors of a public company who committed to purchase

the securities at issue pursuant to a privately-negotiated deal before the effective date of the Registration Statement. As stated in the Petition, Plaintiffs were sophisticated investors with significant due diligence rights, pursuant to which they committed to acquire Premiere shares via Stockholder Agreements. *See* Pet. at 2-5. Plaintiffs did not acquire their shares in the public market and are, instead, insiders who have no need for the protections of the Securities Act. The protections of the Securities Act were intended to reach only public-market purchasers who would otherwise not be entitled to or have access to inside information like that made available to Plaintiffs here. *See, e.g.*, 77 Cong. Rec. 2910, 2982-83 (May 5, 1933), *reprinted in* 1 Fed. Sec. Laws 168, 218-19 (1983); H.R. Rep. No. 73-85 at 2-3 (May 5, 1933). If, pursuant to this Court's review, *Gustafson* definitively bars Section 11 standing for Plaintiffs, they would have no remaining claim in this case, and any lower court proceedings would be moot.

Plaintiffs further contend that the "Eleventh Circuit upheld [their] standing despite explicitly assuming (without deciding) *Gustafson*'s applicability to this case. . . ." Br. in Opp'n at 6. As an initial matter, the Eleventh Circuit noted that *Gustafson* provided some authority for Petitioners' argument but nonetheless ruled that standing existed. App. at 8 n.5. Moreover, Plaintiffs abandoned at oral argument their Section 12 claim, presumably because they knew it was barred by *Gustafson*. *See* App. at 2. It follows that, if *Gustafson* applies to Section 11, then Plaintiffs' case would have been dismissed in its entirety. Thus, Plaintiffs cannot credibly argue that *Gustafson* was not relevant in the Court below.

Overlooking the binding and dispositive authority of this Court's precedent, the Eleventh Circuit wrongly invoked the integration doctrine, which has never been applied to a Section 11 claim, to convert the private deal as to these Plaintiffs into a public one.[1] App. at 9-10. Thus, although the Eleventh Circuit recognized *Gustafson*'s potential impact on the case, it nonetheless ignored *Gustafson*'s guidance and carved out an exception to provide Section 11 standing to directors and officers, like Plaintiffs here, who had due diligence rights and access to confidential, inside information. In addition, although observing that, when Congress enacted Section 11, it is unlikely that it "contemplated the factual scenario present in this case[,]" and that Plaintiffs would be deemed to have received their stock in a private deal but for the integration doctrine, the Eleventh Circuit nevertheless granted Plaintiffs standing to assert their Section 11 claim. App. at 9, 15. Consequently, in both actual analysis and practical effect, the Eleventh Circuit failed to apply *Gustafson* as demanded by this Court's articulation therein of the policy underlying the Securities Act.

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[1] Agreeing that the integration doctrine has never been applied in the Section 11 context, Plaintiffs assert that this Court cannot consider the issue of the applicability of the integration doctrine to the present facts because Defendants addressed it in a footnote in their Petition. Br. in Opp'n at 7. Plaintiffs misunderstand Defendants' arguments. Defendants are not attempting to place the integration doctrine squarely before this Court. Instead, Defendants' Petition focuses on the extension of *Gustafson* to Section 11. As a result, Defendants assert that Plaintiffs are barred from Section 11 standing according to the principles underlying the Securities Act, as articulated in *Gustafson*. Defendants only reference the integration doctrine where necessary to demonstrate the fundamental contradiction between *Gustafson* and the Eleventh Circuit's holding.

II. Plaintiffs' Arguments[2] Would Incentivize Corporate Insiders to Breach Their Fiduciary Duties to Shareholders.

Plaintiffs' argument that this case turns on factually specific questions and "[i]s [n]ot a [p]roper [v]ehicle for [r]esolving the [q]uestion [p]osed by Petitioners" is misleading. Br. in Opp'n at 6.

Expanding Section 11 standing to directors and inside investors would be inconsistent with corporate governance

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[2] Plaintiffs unconvincingly suggest that "[p]rudential considerations" counsel against allowance of the writ. Br. in Opp'n at 9. The procedural posture of this case presents no barrier to effective review by this Court because the District Court has represented that it will defer any merit-based decisions in the case, pending this Court's resolution of the Petition and any briefing and argument on the merits. In addition, given the threshold nature of the Petition, further proceedings in this case at the District Court level would not only tax the parties' resources, but would also waste judicial resources. Accordingly, resolving this issue now would benefit the parties in this case as well as all those involved in this important area of securities law affecting public companies. Lastly, the cases cited by Plaintiffs to advocate that a writ of certiorari should not be granted where proceedings are pending in the lower courts are distinguishable. *See id.* In *Brotherhood of Locomotive Firemen & Enginemen v. Bangor & Aroostook Railroad Co.*, 389 U.S. 327, 328 (1967), this Court declined the writ because the Appeals Court had remanded the case for further factual findings that would be relevant to this Court's review. Such is not the situation in the instant case. *See* App. at 21; *see also Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916) (denying application for writ of certiorari because "the application was opposed by the present petitioner upon the ground that the case, however important to the parties, involved no question of public interest and general importance, nor any conflict between the decisions of state and [f]ederal courts, or between those of [f]ederal courts of different circuits"); *Am. Constr. Co. v. Jacksonville, T. & K.W. Ry. Co.*, 148 U.S. 372, 384, 388 (1893) (discussing distinctions between appeal from an interlocutory order and a final decree and ultimately granting order "to show cause why a writ of certiorari should not issue").

principles. Directors of public companies perform an essential gatekeeping function to protect shareholders from fraudulent conduct. To fulfill their fiduciary obligations to shareholders, such directors, empowered with due diligence rights, must, at a minimum, act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation's best interest. *See Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 927-28 (Del. 2003) (describing conduct entitled to the presumption created by the business-judgment rule). The extension of Section 11 standing to such corporate fiduciaries and gatekeepers will discourage them from properly exercising these obligations. If inside investors may seek to recover any financial losses accruing to them via a Section 11 claim with a lower threshold for liability than a securities fraud action under Section 10(b),[3] they will lack the proper incentive to exercise their responsibilities to the fullest extent required by their fiduciary obligations.

A clarification of *Gustafson* is particularly timely, given the increasing legal and policy emphasis on directorial responsibilities toward shareholders. Congress has specifically spoken on this issue via the Sarbanes-Oxley Act, which authorized enhanced criminal sentences for fraudulent conduct by directors and officers. *See* Sarbanes-Oxley Act of 2002 §§ 805, 1104 (2002); 28 U.S.C. § 994. The Securities and Exchange Commission (SEC) has likewise reinvigorated enhanced scrutiny of directors and has propounded a view of directors as "gatekeepers." In the SEC's own words, directors

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[3] 15 U.S.C. § 78j(b).

> must redefine corporate governance with practices that go beyond mere adherence to new rules and demonstrate ethics, integrity, honesty, and transparency. . . . Directors must ensure that they remain the true stewards of corporate accountability, and their actions must demonstrate their dedication to this stewardship without undue interference. . . .

SEC Chairman William H. Donaldson, Remarks Before the Directors Education Institute (Mar. 16, 2005) (*available at* http://www.sec.gov/news/speech/spch031605whd.htm). Even in the legal realm, there has been a recent spate of high profile cases in which the Delaware courts and others have spoken to the issue of directors' fiduciary duties to the shareholders of public companies. *See, e.g., In re Enron Corp. Sec., Deriv. & ERISA Litig.*, 258 F. Supp. 2d 576 (S.D. Tex. 2003); *Beam v. Stewart*, 845 A.2d 1040 (Del. 2004); *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275 (Del. Ch. 2003); *In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917 (Del. Ch. 2003). Thus, the timeliness and relevance of the issues raised by this case concerning the duties and obligations of directors provide this Court with an opportunity to speak on current developments in corporate governance and militate in favor of allowing the writ so as to provide guidance on these important questions.

CONCLUSION

This Petition should be granted fundamentally because there is disagreement among the lower courts over the applicability of *Gustafson* to claims brought under Section 11. Clarification of *Gustafson* will, therefore, have a meaningful impact on Section 11 standing and on the

scope of the remedies available under the Securities Act. In particular, *Gustafson* should be explicitly held to bar Plaintiffs from seeking recovery under Section 11. For these reasons, the Petition for Writ of Certiorari presents a question that is ripe for this Court's review and should be granted.

Respectfully submitted,

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